

IT 95-1
Tax Type: INCOME TAX
Issue: Unitary Apportionment

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
ADMINISTRATIVE HEARINGS DIVISION
CHICAGO, ILLINOIS

THE DEPARTMENT OF REVENUE)
OF THE STATE OF ILLINOIS)
) Case No.: XXXXX
v.) FEIN: XXXXX
)
XXXXX,) Harve D. Tucker,
Taxpayer) Administrative Law Judge

RECOMMENDATION FOR DISPOSITION

APPEARANCES: Sean Cullinan, Special Assistant Attorney General, of Chicago, Illinois, for the Department of Revenue XXXXXXXXXXXXX, for the Taxpayer

SYNOPSIS This is a case involving XXXXX of (hereinafter "Taxpayer"). On June 25, 1992, the Illinois Department of Revenue issued a Notice of Deficiency (Department of Revenue Exhibit 2) proposing to assess the following: TYE 7/26/89 for \$16,794 tax plus \$2,594 Sec. 1005 (35 ILCS 5/1005) penalty; TYE 7/25/90 for \$11,195 tax plus \$1,065 Sec. 1005 penalty. The proposed deficiency is based on the finding by the Department of Revenue that the Taxpayer and XXXXX, a XXXXX corporation (hereinafter "XXXXX corporation") comprised a unitary group. By its protest (DOR Exh. 4), the Taxpayer objected to the Department's determination.

On consideration of the matters, it is recommended that the issue be resolved in favor of the Taxpayer.

FINDINGS OF FACT

1. XXXXX owned 75% of XXXXX and 100% of . (Tr., pp.17, 52)
2. XXXXX is a wholesaler of poultry products. It buys prepackaged poultry or bulk chickens from poultry processors and resells them to

wholesalers. They have no warehouse facilities. (Tr., pp.18, 43, 44)

3. is a wholesale distributor of fresh frozen poultry, beef, pork, cheese, salads and eggs. They have a warehouse, coolers and freezers. They sell their products to retail grocery stores, small distribution centers and small warehouses. (Tr., pp.18, 43, 44, 95)

4. The corporations do not engage in joint purchasing nor do they use any of each other's facilities or salesmen. (Tr., pp.103-104)

5. XXXXX was in contact with daily and visited the location occasionally. (Tr., p.19)

6. XXXXX is the manager of XXXXX. He buys, sells and prices the product, oversees the sales force and the entire company. (Tr.. p.45)

7. is run by two managers. XXXXX is the manager of operations (inventory, warehouse, trucking, loading and drivers; accounts receivable, computers, interoffice functions and deposits). He is also the poultry buyer. XXXXX is the sales manager and is also in charge of buying all products except poultry. (Tr., pp.45, 62, 101)

8. XXXXX was in contact with XXXXX on a daily basis and they talked about sales prices and market conditions. (Tr., p.19)

9. XXXXX make all decisions for with regard to advertising and purchases. Neither XXXXX makes decisions as to where they buy the product, from whom they buy the product, what price they pay, employee decisions (including hiring, firing and salaries), advertising decisions or marketing decisions. These decisions were made by XXXXX in XXXXX, Illinois. (Tr., pp.46, 102-103, 112-113)

10. For TYE 7/89, approximately 39% of ' purchases were of poultry products. Of this, almost 47% was purchased from XXXXX, or a little more than 18% of their total purchases. For TYE 7/90, approximately 31% of ' purchases were of poultry products. Of this, 28% was purchased from XXXXX, or nearly 9% of their total purchases. Price, availability and being able

to buy less than load lots were the determinative factors. (DOR Exh. 11, Tr., pp.20, 96-97, 114)

11. For TYE 7/89, less than 10% of XXXXX sales were to It may have been as little as four to five percent. The price is off of a price schedule based on the live market of chickens. It is the same price XXXXX sells to other customers. (Tr., pp.35, 47)

12. XXXXX also sells to competitors of . (Tr., p.48)

13. The assets of the Taxpayer have not been pledged to secure loans to the XXXXX corporation, nor have assets of the XXXXX corporation been pledged to secure loans to the Taxpayer. (Tr., p.48)

14. There have been no joint loans to both the Taxpayer and the XXXXX corporation. (Tr., p.49)

15. When needed financing, XXXXX personally guaranteed the loan. (Tr., p.61)

16. There are no intercompany loans. (Tr., pp.75-76)

17. Neither company owns property which is used by the other company. (Tr., p.49)

18. There are no intercompany payments other than for accounting services and poultry purchases. (Tr., p.76)

19. XXXXX' bonus is based on the pre-tax profit of XXXXX. XXXXX's bonuses are based on the pre-tax profit of . (Tr., p.50)

20. The Taxpayer and the XXXXX corporation maintained separate bank accounts at separate banks. (Exh. 10) Two bank accounts of were in XXXXX (both at XXXXX National Bank) and one was in Illinois (Bank of XXXXX). Funds were transferred daily from Bank of XXXXX to XXXXX. (Tr., pp.55, 63) The signatories on the comapny's bank accounts at XXXXX were XXXXX, XXXXX, XXXXX and XXXXX. XXXXX did not have to approve any payments. XXXXX were signatories on the account at Bank of XXXXX. (Tr., pp.57-59, 67-68)

21. XXXXX set the salaries for all of the employees. (Tr., p.60)

22. XXXXX negotiated the union contract for . XXXXX was not involved in the negotiations. (Tr., pp.60-61)

23. Prior to October, 1989, the CPA firm of XXXXX, through XXXXX, a principal in the firm, provided accounting services for . This included general ledger posting and preparation of financial statements, payroll tax returns and income tax returns. Their fees were paid by . (Tr., p.70)

24. When XXXXX became a full-time employee of XXXXX, he performed the same functions. Additionally, he was given signature authority and could sign accounts payable checks for . Approvals for payments were generated from . Although XXXXX could revoke approval, he never did. (Tr., pp.72, 82, 85)

25. XXXXX conducted a review to establish a charge to be paid by to XXXXX for these functions. (Tr., pp.72-75)

26. The computer systems of and XXXXX are not linked. (Tr., pp.91, 100-101)

27. The accounting and tax work for done by XXXXX included accounts payable (Tr., pp.22, 34)

28. The accounting functions performed by included inventory, payroll and accounts receivable. Although he reviewed the accounts receivable, XXXXX was not involved in collections. (Tr., pp.59, 101)

CONCLUSIONS OF LAW 35 ILCS 5/1501(a)(27) provides:

The term "unitary business group" means a group of persons related through common ownership whose business activities are integrated with, dependent upon and contribute to each other. *

* * Unitary business activity can ordinarily be illustrated where the activities of the members are: (1) in the same general line (such as manufacturing, wholesaling, retailing of tangible personal property, insurance, transportation or finance); or (2) are steps in a vertically structured enterprise or process (such as the steps involved in the production of natural resources, which might include exploration, mining, refining, and marketing); and, in either instance, the members are functionally integrated through the exercise of strong centralized management (where, for example, authority over such matters as purchasing, financing, tax compliance, product line, personnel, marketing and capital investment is not left to each member).

The existence of common ownership is indisputable. The second test is also satisfied - the companies are in the same general line of business, i.e., wholesaling.¹ The only test remaining is whether the companies are functionally integrated through the exercise of strong centralized management, and it is here where the evidence is insufficient to establish that a unitary relationship exists.

The evidence presented demonstrates that the Taxpayer was operated independently of and was not functionally integrated with the XXXXX corporation.

The Taxpayer is operated by XXXXX and XXXXX, out of the Taxpayer's office in XXXXX, . They control all of the operational matters of the corporation - including purchasing, selling, advertising, marketing and employment, including union negotiations - independently, without the approval of any of the officers, directors or employees of the XXXXX corporation. The sales forces are independent, and there is no other exchange or rotation of personnel between the companies. Neither do XXXXX have any involvement in the operation of the XXXXX corporation.

Intercompany sales, arguably somewhat significant, are ordered and priced at arm's length. There are no economies of scale. There are no joint purchases or uses of equipment or property, and no intercompany loans or guarantees. There have been no joint loans and neither company's assets have been pledged to secure loans to the other company. The accounting and computer systems are independent. Prior to October, 1989, accounting services were provided by an outside CPA firm, which charged the Taxpayer for such services. For part of the second audit period at issue, the XXXXX corporation provided accounting services to the Taxpayer, for which service the Taxpayer paid a fee. The Taxpayer and the XXXXX corporation maintained separate bank accounts at separate banks and there is no evidence of any commingling of funds or intercompany or joint accounts.

The only possible connection of the two companies is through the common ownership, officers and Boards of Directors. Because the shares of stock of both corporations were closely held by the same family, the Department made conclusions; these conclusions are not supported by the record. While the potential control to be exercised by such commonality is apparent, that is not enough to find that a unitary business group exists.² Although XXXXX was in regular contact with the Taxpayer, the Department was not able to prove any operational control by XXXXX or any other person.

It has been clearly shown that the companies were operated independently and were not functionally integrated. Administrative functions, rather than managerial functions, were centralized. It is recommended that the Notice of Deficiency be withdrawn.

Harve D. Tucker
Administrative Law Judge

Date:

1 Although the businesses differ somewhat as to product and customer, the Act does not make that distinction consequential.

2 See *Allied-Signal, Inc. v. Director, Division of Taxation*, 504 U.S. --, 112 S.Ct. 2251 (1992); *F.W. Woolworth v. Taxation and Revenue Department of New Mexico*, 458 U.S. 354 (1982).